National Association of Towns and Townships

September 30, 2016

Update on DOL Overtime Rule and HQLA

DOL Overtime Rule

Background:

The Fair Labor Standards Act (FLSA) requires that most employees be paid at least the federal minimum wage for hours worked and overtime pay at time and one-half for hours worked over 40 hours per week. There are exemptions from both minimum wage and overtime pay for certain "white collar" employees. To qualify for those exemptions, employees must meet certain job duty tests and be paid a salary of at least $455 per week (or $23,660 per year). In July 2015, the U.S. Department of Labor (DOL) released a proposed rule that would increase the salary threshold an employee must hit to be overtime exempt to $970 per week (or $50,440 per year). That is a 113% increase. Additionally, the threshold will automatically increase to keep pace with inflation (minimum salary to match the 40th percentile of the average salary earned by full-time employees). Opponents of the rule are concerned that the increased salary threshold and automatic increases do not take into account regional cost of living differences.

Recent activity:

President Obama and DOL Secretary Tom Perez announced the publication of the final overtime rule on May 18, 2016. The effective date of the final rule is **Thursday, December 1, 2016**. Specifically, the final rule:

- Sets the standard salary level at the 40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region, currently the South (**$913 per week; $47,476 annually for a full-year worker**). While lower than originally proposed, this is still a more than a 100% increase.
- Sets the total annual compensation requirement for highly compensated employees (HCE) subject to a minimal duties test to the annual equivalent of the 90th percentile of full-time salaried workers nationally ($134,004).
- Establishes a mechanism for automatically updating the salary and compensation levels every three years to maintain the levels at the above percentiles and to ensure that they continue to provide useful and effective tests for exemption.

Again, initial increases to the standard salary level (from $455 to $913 per week) and HCE total annual compensation requirement (from $100,000 to $134,004 per year) will be effective on December 1, 2016. Future automatic updates to those thresholds will occur every three years, beginning on January 1, 2020.

Legislation has been introduced to counter the final rule. A flurry of activity occurred the week of September 26. On September 28, the House passed H.R. 6094, which would delay for six months implementation of the overtime rule. The vote was 246 to 177, with only 5 Democrats voting in favor of the bill. On the same day, Senators James Lankford (R-OK), Lamar Alexander (R-TN) and Susan Collins (R-ME) introduced S. 3462, a companion measure to H.R. 6094. The White House issued a veto threat on this move to delay implementation. Also on September 28, Senator David Vitter (R-LA) introduced S. 3420, which would delay the rule's implementation by two years in states where the President has declared a major disaster. On September 29, Senators Lamar Alexander (R-TN), Susan Collins (R-ME), James Lankford (R-OK), Tim Scott (R-SC), and Jeff Flake (R-AZ) introduced a bill that would phase in the new salary threshold over five years, and would require the Government Accountability Office to conduct a report during the rule's first year to assess its economic effects. Should these be unfavorable, then nonprofits, colleges and universities, state and local governments, and health care organizations that received more than half their funding from Medicare and Medicaid would be exempted from the rule. A similar measure in the House, H.R. 5813, was introduced by a group of 14 House Democrats and Republicans on July 14, 2016, and that bill would initiate a three-year phase-in of the final DOL overtime rule, beginning with a 50% increase this December to $35,984.

On March 17, 2016, the Protecting Workplace Advancement and Opportunity Act (H.R. 4773/S. 2707) was introduced in the House and Senate, which would completely nullify the rule and require DOL to conduct a comprehensive economic analysis on the effect the overtime changes would have on small businesses, nonprofits and public employers. The bill would also prevent the exempt salary threshold from automatically increasing, even in subsequent similar rules.

Finally, on September 20, 2016, officials from 21 states filed a lawsuit claiming that the final DOL overtime rule will place a heavy burden on state budgets and that DOL abused its authority by increasing the salary threshold so drastically. The 21 states who filed the lawsuit are: Alabama, Arizona, Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Michigan, Mississippi, Nebraska, Nevada, New Mexico, Ohio, Oklahoma, South Carolina, Texas, Utah and Wisconsin.

HQLA

Background:

In 2014, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve and the Office of the Comptroller of the Currency (OCC) approved the Liquidity Coverage Ratio rule. The rule established a minimum liquidity requirement for large banking organizations and identified acceptable investments – deemed high quality liquid assets (HQLA) – to meet this requirement. The rule failed to include municipal securities in any of the acceptable investment categories. Not classifying municipal securities as HQLA could increase borrowing costs for communities to finance public infrastructure projects, as banks will likely demand higher interest rates on yields on the purchase of bonds during times of national economic stress, or even forgo altogether the purchase of securities during these times. On February 1, 2016, the House approved H.R. 2209 by voice vote, which would require the appropriate Federal banking agencies to treat certain municipal obligations as level 2A liquid assets.

Recent activity:

On April 1, 2016, the Federal Reserve released final rule changes to treat more municipal securities as HQLA, but critics complain they do not go far enough and could hurt the municipal bond market. The final rule changes treat as level 2B liquid assets municipal general obligation bonds that are backed by the full faith and credit of a U.S. state or municipality, are investment grade, and have been issued by an entity whose obligations have a proven track record as a reliable source of liquidity during periods of significant stress. These bonds would still have to meet the liquid and readily marketable standard outlined in the rule to be considered level 2B assets[1].

[1] There are three classifications of liquidity in the rule, level 1, level 2A and level 2B. Level 2B, which includes some corporate debt, is the lowest liquidity classification in the rule.

Under the rule, only 40% of an institution's aggregate HQLA can be made up of level 2A and 2B assets, with only 15% of the total HQLA coming from level 2B assets.

The rule changes took effect on July 1, 2016, but other banking regulators, the FDIC and OCC, still exclude municipal bonds as HQLA. So, with only the Federal Reserve acting, the rule has limited impact. The Federal Reserve regulates bank holding companies, while the banks themselves are overseen by either the OCC or the FDIC, depending on whether they have national or state charters.

On September 27, 2016, Senators Mike Rounds (R-IN) and Mark Warner (D-VA), along with eight original cosponsors[2], introduced S. 3404, the Senate version of H.R. 2209. S. 3404 is almost identical to H.R. 2209, except that it classifies municipal bonds as 2B instead of 2A. The chart below explains the differences between HQLA level assets:

HQLA = Level 1 asset amount + Level 2A asset amount + Level 2B asset amount - Greater of [Unadjusted excess HQLA amount, Adjusted excess HQLA amount]

Parameter	Level 1 asset	Level 2A asset	Level 2B asset
Quality	• Highest quality and most liquid assets	• Relatively stable and significant sources of liquidity	• Lesser degree of liquidity and more volatility
Amount included	• Fair value of all Level 1 assets less reserve balance requirement under section 204.5 of Regulation D (no haircut)	• 85 percent of fair value of Level 2A assets (15 percent haircut)	• 50 percent of fair value of Level 2B assets (50 percent haircut)
Limit to inclusion	• No limit	• Level 2A + Level 2B < 40 percent of HQLA	
		• No individual limit	• < 15 percent of HQLA
HQLA criteria	• Federal Reserve bank balances • Foreign withdrawable resources • Securities issues or guaranteed by the U.S. government • Securities issued or guaranteed by certain sovereign entities and multilateral development bank (MDB)	• Securities issued or guaranteed by a U.S. government-sponsored enterprise (GSE) • Securities issued or guaranteed by certain sovereign entities or MDBs	• Certain investment grade corporate debt securities issued by non-financial sector entities • Certain publicly traded common equity shares of companies included in the Russell 1000 index or eligible foreign index
Eligible HQLA	• Additional requirements to qualify as eligible HQLA – Operational requirements (e.g., capability to monetize HQLAs, maintain appropriate policies, etc.) – Generally applicable requirements (e.g., collateral free of encumbrances and other restrictions, etc.)		

NATaT will continue to keep you updated on these two important issues to local governments.

[2] Senators Charles Schumer (D-NY), John Tester (D-MT), Mark Kirk (R-IL), Heidi Heidkamp (D-ND), Tim Scott (R-SC), Jerry Moran (R-KS), David Vitter (D-LA), Joe Donnelly (D-IN)